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587314—44

In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 923

WELSBACH ENGINEERING AND MANAGEMENT CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 73a–75a) is not reported. The opinion of the Circuit Court of Appeals (R. 77–82) is reported at 140 F. 2d 584.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 28, 1944. (R. 83.) Petition for writ of certiorari was filed April 24, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the provisions of the contract upon which petitioner relies restricted the payment of dividends during the tax years in question within the meaning of Section 26 (c) (1) of the Revenue Act of 1936.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 26. CREDITS OF CORPORATIONS.
>
> In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—
>
> * * * * *
>
> (c) *Contracts Restricting Payment of Dividends.*—(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.
>
> * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. *Credit in connection with contracts restricting payment of dividends.*— (a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

(2) Those which come within section 26 (c) (2), in that they require the payment, or irrevocable setting aside, within the taxable year, of a specified portion of the earnings or profits of the taxable year for the discharge of a debt incurred on or before April 30, 1936.

If a corporation is restricted with respect to the payment of dividends by two or more contract provisions coming within section 26 (c) (1), only the largest of the credits computed with respect to each of

such provisions, and not their sum, shall be allowable under section 26 (c) (1) and, for such purpose, if two or more credits are equal in amount, only one shall be taken into account. However, section 26 (c) (3) provides that if both section 26 (c) (1) and section 26 (c) (2) apply, only the one of such paragraphs which allows the greater credit shall be applied, and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

* * * * *

STATEMENT

The pertinent facts as found by the Tax Court (R. 69a–73a) may be summarized as follows:

Petitioner is a Delaware corporation doing business in Pennsylvania (R. 69a).

From 1928 to December 24, 1936, all of petitioner's outstanding bonds of an original issue of $2,400,000, were owned by The American Gas Company, hereinafter referred to as American. This company had ceased activities in 1927 except as a holding company. From that year to 1936 practically all of its outstanding stock was owned by United Gas Improvement Company, hereinafter referred to as United. In 1936 the small outstanding balance of American stock was acquired by United, and in December of that year it was the owner of all the issued stock of American. (R. 70a.)

Petitioner's bonds hereinbefore referred to were issued under a trust indenture covering all of its assets and properties. By the terms of the indenture it was obligated to make annual payments to the trustees for purposes of a sinking fund in the sum of $106,000 payable semiannually in equal installments. (R. 70a.)

Petitioner was indebted to the Chase National Bank of New York in the sum of $250,000, representing loans made to petitioner for the purpose of meeting current expenses. In January, 1933, the bank demanded payment of this indebtedness and petitioner thereupon proceeded to make arrangements to meet the situation. It entered into negotiations with American for modification of the conditions of the aforementioned trust indenture to permit the deferment of the sinking fund's payment due in 1934, and for the release of certain of its assets from the trust, in order that they might be placed with the bank in securing an extension of the loan. These negotiations were carried on with the officers of American who were also officers and directors of United, and the several agreements resulting therefrom were prepared under the direction of United's general counsel. (R. 70–71a.)

The arrangement ultimately effected was that American agreed to a deferment of the sinking fund payments for 1934, and to a modification of the trust indenture covering the bond issue.

Under the modification of the trust indenture, petitioner was required to and did enter into a contract restricting payment of dividends and any increase in its officers' salaries. This agreement was prepared under the direction of the general counsel of United acting for American, and was embodied in a letter addressed to American dated January 5, 1934, delivered to American (R. 71a) and reading as follows (R. 72a):

261 North Broad Street,
Philadelphia, Penna.,
January 5, 1934.

The American Gas Company,
1401 Arch Street, Philadelphia, Pa.

Gentlemen: In consideration of the consent of your Company, as the holder of all of this Company's outstanding Collateral Trust Six Per Cent. Fifteen Year Sinking Fund Gold Bonds, to the execution and delivery of the Indenture dated as of December 29, 1933, supplemental to the Indenture dated as of January 1, 1923, from our Company to Fidelity Trust Company securing said bonds, we agree that so long as your Company shall hold any of said bonds that our Company will not, without the prior written consent of your Company, pay any dividends on its capital stock or increase the salaries of its executive officers, either as officers of our Company or of its Subsidiary Companies, above the respective amounts of such salaries on

January 1, 1934, as set forth in a list which we have delivered to Mr. W. W. Bodine, Vice-President of your Company, and that the proper amount of depreciation and obsoleseence [obsolescence] charges to be set aside by our Company and its Subsidiary Companies under the provisions of Section 2 of Article Two of said Indenture dated as of January 1, 1923, as amended by said Supplemental Indenture, shall be determined annually by agreement with your Company.

Yours very truly,

WELSBACH STREET ILLUMINATING COMPANY,

By, [s] EUGENE S. NEWBOLD,

President.

On January 5, 1934, petitioner's directors authorized the execution of the supplemental modified trust indenture and the signing of the above letter by petitioner's president on its behalf. On December 8, 1936, the stockholders of American voted for its dissolution. Thereafter on December 24, 1936, all of its assets including all of petitioner's bonds then outstanding and in the amount of $926,000 were transferred and distributed to United, American's sole stockholder. (R. 73a.)

The Tax Court held that petitioner was not entitled to credit against its adjusted net income under the provisions of Section 26 (c) (1) of the Revenue Act of 1936. The court said that

since the restriction on dividends, contained in petitioner's letter of January 5, 1934, to American, was in terms to endure only so long as American held any of the bonds, the restriction was removed when American was dissolved and its assets taken over by United on December 24, 1936, a date prior to the close of the first taxable year for which petitioner claims the benefit of the statutory credit. (R. 73a–75a.) The Circuit Court of Appeals affirmed (R. 77–83).

ARGUMENT

There is no occasion for further review of this case. It was correctly decided below, and presents no question of conflict among the circuit court of appeals. Petitioner concedes (Pet. 12) that the case "turns on" the construction of a clause in the letter quoted above, an issue obviously not of general importance.

Section 26 (c) (1) of the Revenue Act of 1936, in so far as pertinent here, allows a credit for so much of its net income as a corporation is prohibited by contract from paying out as dividends.[1] The restrictive provision embodied in the letter of January 5, 1934, would have enabled petitioner to take advantage of this section if the contract had remained in effect. But by its terms the critical covenant was to endure only so long as American held any of petitioner's

[1] Later revenue laws contain no provision corresponding to Section 26 (c) (1) of the 1936 Act.

bonds, and American ceased to hold any of the issue prior to the close of the first of the tax years here involved.[2] Thus the contract provision restricting dividend payments on which petitioner's case rests was not operative during the tax years for which the credit is asserted. That petitioner continued to deem itself bound by the covenant is, of course, entirely immaterial. *Helvering* v. *Magnus Beck Brewing Co.*, 132 F. 2d 379 (C. C. A. 2d), certiorari denied, 319 U. S. 749. See also *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102.

The gravamen of petitioner's case is that the duration of the restrictive provision was coextensive with the holding of the bonds directly or indirectly by United, the parent corporation. But as the court below held, there is no justification for that contention in the terms of the pivotal letter, which is addressed to the subsidiary as the holder of the bonds and plainly conditions the agreement not to pay dividends upon a continued holding of the bonds by American. (R. 72a). Such unambiguity stood in need of no "interpretation;" and manifestly it was not the function of either the Tax Court or of the court below to "construe" a different contract from that which the parties had made for themselves. Particularly is this so in a case

[2] Obviously the restriction upon payment of dividends must endure throughout the entire tax year if it is to prevent distribution "within the taxable year."

involving a "special credit in the nature of a deduction". *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102, 106.

Contrary to the position which petitioner takes here, neither the Tax Court nor the Circuit Court of Appeals rested its decision on the ground that as a matter of law the language of the letter alone bespoke the parties' agreement; we do not need to consider whether, as urged (Pet. 8, Br. 17), there exists some division of opinion among the Circuits with respect to the applicability of the parole evidence rule in a proceeding of this kind. For it is plain from the Tax Court's findings and opinion (R. 69a–75a) that it *did* admit and consider all of the "parole evidence" adduced by petitioner in aid of its contention that United was the real party at interest to this contract, and thus that the restriction against dividends "carried over" beyond the cessation of holding by American. It is equally plain in the opinion below (R. 80) that the Circuit Court of Appeals recognized the materiality of other elements besides the terminology of the critical letter. Fundamentally, the petitioner's complaint is only that its contention was rejected on evidence, *including* the letter, which pointed to the conclusion that American was the contracting party, and that the agreement meant what it so unequivocally said—and no more. But, of course, the Tax Court was entitled to choose among conflicting inferences, and certainly the evidence in

support of its determination was sufficiently substantial to conclude the matter in the court below.[3] *Dobson* v. *Commissioner,* 320 U. S. 489; *Helvering* v. *Stock Yards Co.,* 318 U. S. 693; *Wilmington Co.* v. *Helvering,* 316 U. S. 164.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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MAY 1944.

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[3] Thus, as opposed to the testimony of petitioner's officers and those of United that the parties intended United as the covenantee of the restrictive provision, the documentary history of this transaction tended to show that both petitioner and United contemporaneously regarded American as owner of the bonds and the contracting party. United, to whom the bonds were originally issued, transferred them to American in 1928 (R. 70a); it was to American, not to United, that petitioner first wrote requesting deferment of payment under the trust indenture (R. 24a–25a). Likewise, it was American, not United, which signed the agreement permitting subordination of the indenture lien to the bank loans which petitioner was negotiating; and it was American, not United, which by appropriate resolution consented to execution of an amendment to the original sinking fund provisions. (R. 30a–32a, 36.)

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